Preface

The author of this text is Peter C Dawson. At times I will refer to myself, for ease of distinction between myself and other authors cited, as the "present author" of this text. The author is solely responsible for the content of this text.

Peter earned a PhD in Economics at the University of Connecticut in 1999. He also earned an MA in Economics in 1990 and a BA in Economics in 1988 at the University of Connecticut. For five years while working on his PhD, Peter taught 27 college Economics courses, in various Economics subjects, at several universities, including the University of Connecticut, Eastern Connecticut State University, the University of Hartford, and Bentley College. Peter worked as an Economist with the IRS in Dallas, TX for 8 years before becoming a stay-at-home dad with his two young children. Peter attended and passed the American Society of Appraisers' (ASA's) four core Business Valuation courses (i.e., BV201, BV202, BV203 and BV204) and attended advanced ASA and NACVA training seminars in an effort to become acquainted with generally accepted business valuation theory and practice. Peter is not, nor does he represent himself to be, an accredited business appraiser, or an expert on generally accepted business valuation theory and practice. Nevertheless, he has made a sincere effort to properly characterize business valuation theory and practice, as well as the works of other authors. Should there be any errors in his characterizations, the author apologizes and notes that they are unintentional and not knowingly made.

Although the content of this text appears to the present author, at the time of publication, to be sound and straightforward, it has not been subject to an independent peer review process over a sufficient period of time to say that all the kinks and/or errors have been found and remedied. This text is a work in progress and, as such, may not represent the final word on the issues presented. The publication of this First Edition will constitute, through its reading and review by the author's peers, exposure to independent peer review. Additional editions may be forthcoming should revisions be appropriate in response to peer review, discussion, debate, and suggestions made to the author for improvements, and should there be sufficient interest. It is the present author's hope that this text, through its presentation of new and potentially insightful ideas, will serve as a catalyst to intellectual discussions of substance among and between academics and valuation

practitioners that might, in turn, set in motion fundamental advances in the fields of Business Valuation, Finance, and Economics.

The proposed views in this text are, in some respects, dramatically different from conventional thinking about the valuation issues and topics that are presented. Given that this text has endeavored to put forth some significant departures from generally accepted valuation theory and practice, the present author provides much detail in an effort to explain—to academics, practitioners, and the layperson—how he arrives at considerably different conclusions. Along with extensive descriptive explanations, he also presents some formal economic analyses to compliment the readers' understanding of an issue or topic. For practitioners who would like to provide substantive, compelling, and convincing support for their deviations from generally accepted business valuation practice, in order to meet a Daubert Challenge for example, this text may provide a useful resource. The present author also makes liberal use of quotations, rather than simply paraphrasing the work of other authors, so that the reader will be left with fewer questions in his mind when reading this text (e.g., "Did the cited author really say that?").

A fundamental purpose of this text has been to ask the unanswered or inadequately answered questions, and to think about and develop well-supported and reasonable answers to them, including questions in the areas of Finance and Financial Economics that are related to business valuation theory and practice. These questions, and perhaps even more so the present author's proposed alternative answers to them, may be the most provocative elements of this text. The content of this text is not meant to undermine the importance of existing achievements in academic or practical disciplines, however. Rather, the author has attempted to provide contributions to the ongoing *development* of business valuation theory and practice (as well as Finance), contributions that may serve as a catalyst towards productive thinking about, or re-thinking of, current business valuation theory and practice (financial theory).

Peter C Dawson
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Abstract and Overview

Conventional business valuation theory and practice may be, in some respects, disconnected from economic theory. Economics underlies much of business valuation theory and practice, yet there appears to be surprisingly little explanation of how it fits into and underlies the typical business valuation analysis. Indeed, analyses of market value are inextricably linked to an underlying foundation of Economics, since market value (and price) is a function of the interaction of market supply and demand. Economics has a prominent role in determining market value, including Fair Market Value, and thus should not, in the present author's opinion, be regarded as peripheral to business valuations. From a larger perspective, this text attempts to link and integrate business valuation theory and practice with its economic underpinnings in formal and explicit ways. Another focus of this text is the practical application of accepted economic principles to the estimation of the Fair Market Value of minority (i.e., non-controlling) interests in closely-held family limited partnerships (FLPs) under the Fair Market Value Standard (FMVS). This text discusses in detail the computation of the Fair Market discount for minority FLP interests—and, more generally, for minority closely-held business interests.

Business appraisers who seek substantive answers to common valuation questions, questions that may not have been adequately answered in the current business valuation literature, may find this text engaging, informative and thought-provoking. The underlying economic foundation for the Fair Market discount is discussed in detail. The author hopes that the contribution(s) in this text might aid appraisers in their efforts to improve their appraisal practice. The discussion of how to apply the FMVS, in strict accordance with its fairly straightforward competitive asset market assumptions, is particularly insightful. The present author not only explores and articulates how economic theory underlies business valuation methodology and how the explicit use of economic principles can improve the reliability of Fair Market Value analyses, he also provides practical tools that may help appraisers in their valuation analyses. For example, see the MAPM Analysis in Chapter 12.

For academic economists, especially those looking for instructive real world examples of Applied Microeconomics, this text may provide several examples of how economic theory is applied in business valuation practice. The reader might discover that some valuation issues

and analyses in the literature, as well as those presented in this text, are still evolving. Given the relative infancy of business valuation theory and practice, there may be niches for further economic research. Researchers and graduate students in the areas of Microeconomics, Financial Economics, Economics of the Law, and Econometrics may wish to explore some of these possible niches for further research. Financial economists may find the author's analysis and conclusions regarding a competitive asset market risk-return relationship, which is discussed in the context of the Traditional CAPM, to be controversial, yet thought-provoking. The author presents an alternative analysis and conclusion regarding Finance's doctrine that there is a positive risk-return relationship in competitive asset market equilibrium. An assumed positive illiquidity (or lack of marketability)-discount for lack of a market (DLOM) relationship is based (at least in part) on Finance's positive risk-return paradigm, which, if incorrect, might undermine the application of a DLOM to minority closely-held company interests with higher-risk than comparable publicly-traded U.S. securities.